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IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

No. 555

R. H. OSWALD COMPANY, INC., *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

WALTER E. BARTON,
Investment Building,
Washington, D. C.,
Counsel for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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OCTOBER TERM, 1950

No.

R. H. OSWALD COMPANY, INC., *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI.

To the Honorable The Chief Justice and The Associate Justices of the Supreme Court of the United States:

Your petitioner, R. H. Oswald Company, Inc., respectfully submits its petition for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit, which judgment affirmed the decision of the Tax Court of the United States in the above-entitled case. (R. 114, 129.)

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on November 10, 1950. (R. 114.) Petition for rehearing was filed on November 24, 1950 (R. 115), and

denied by the Court below on December 15, 1950. (R. 129.) The jurisdiction of this Honorable Court is invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, Title 28, Chapter 81, § 1254, U. S. Code.

STATEMENT OF THE CASE.

This action involves the federal income and excess profits tax liability of petitioner for the fiscal years ended June 30, 1943 and June 30, 1944. (R. 3.)

The question in the Tax Court was whether the compensation of $45,767.83 and $48,503.12 paid by petitioner to Oswald, its president and general manager, for performing all of the executive and management services for petitioner during said respective years was reasonable compensation, within the meaning of Section 23(a), I. R. C. (R. 3, 7.)

The Commissioner of Internal Revenue allowed only $9,600.00 for each year. (R. 9.) The Tax Court determined that a reasonable allowance was $22,500.00 for 1943 and $25,000.00 for 1944. (R. 82.) The Court of Appeals below affirmed the Tax Court. (R. 114, 129.)

Petitioner was organized in 1922 by Oswald and Sparrenberger to conduct the wholesale fruit and vegetable business in Evansville, Indiana. Prior thereto, Oswald had had 11 years experience in that kind of business in Evansville. He has been petitioner's president and general manager ever since its organization; and since 1938, when he bought Sparrenberger's stock, Oswald has performed all of petitioner's executive and management services. (R. 20-22, 25, 28, 29, 35, 41, 42, 78, 79.)

During 1943 and 1944, Oswald devoted 6 days and 5 nights a week to petitioner's business, spending from 15 to 16 hours during each 5-day-and-night period and about 10 hours during the sixth day, and sometimes more. (R. 29-36.)

In 1930, petitioner's Board of Directors placed petitioner's salesmen on a commission basis as an incentive to them; and for the same reason petitioner's Board on Janu-

ary 8, 1930 passed a resolution fixing the compensation of Oswald and Sparrenberger, its two executive officers, at a salary of $7,200.00 each and total additional compensation to both equal to 50% of petitioner's earnings remaining after petitioner earned 20% on its capital stock. (R. 11, 13, 39.)

This resolution was in effect until August 6, 1941, when petitioner's Board passed a new resolution fixing Oswald's salary at $7,200.00 and his additional compensation in an amount equal to petitioner's earnings remaining after petitioner earned 80% on its capital stock, the additional compensation not to be effective, however, until petitioner's net worth exceeded $75,000.00. Similar resolutions were in effect during petitioner's fiscal years 1943 and 1944, except the salary was changed to $9,600.00 due to the increase in the cost of living. The compensation paid to Oswald during these fiscal years was for performing all of petitioner's executive and management services, although customarily four executives are required for such services; and the compensation paid Oswald represented the total compensation paid by petitioner for executive and management services. During some of the depression years in the 1930's, petitioner did not draw his entire salary of $7,200.00. (R. 11, 13-15, 38-41, 64.)

Petitioner's net sales, net income, and amounts paid to Oswald and Sparrenberger from 1922 to 1938, inclusive, and to Oswald from 1939 to 1946, inclusive, and deducted on petitioner's income tax returns as officers' compensation for said respective years, were as follows:

Taxable Year	Net Sales	Net Income	Oswald	Sparrenberger	Total
1923	$ 356,354.38	$11,423.21	$ 2,700.00	$ 2,700.00	$ 5,400.00
1924	566,442.32	19,718.13	3,600.00	3,600.00	7,200.00
1925	589,301.61	17,212.14	4,500.00	4,500.00	9,000.00
1926	830,708.88	31,593.10	5,200.00	5,200.00	10,400.00
1927	834,759.99	32,070.46	6,000.00	6,000.00	12,000.00
1928	1,004,471.18	33,138.88	6,000.00	6,000.00	12,000.00
1929	996,997.08	24,851.15	7,200.00	7,200.00	14,400.00
1930	1,111,010.13	12,809.52	10,604.81	10,604.81	21,209.62
1931	1,106,296.44	10,764.75	9,582.38	9,582.38	19,164.76
1932	750,063.50	417.22	6,600.00	6,600.00	13,200.00
1933	483,600.99	(10,105.01)	6,000.00	6,000.00	12,000.00
1934	635,134.69	3,019.06	5,000.00	5,000.00	10,000.00
1935	535,616.54	(5,708.60)	5,000.00	5,000.00	10,000.00
1936	786,924.03	8,790.61	8,595.31	8,595.30	17,190.61
1937	365,406.51	2,640.72	7,200.00	7,200.00	14,400.00
1938	731,720.17	3,860.61	7,200.00	2,216.67	9,416.67
1939	745,010.57	(733.01)	7,200.00	.....	7,200.00
1940	809,626.90	5,394.74	7,200.00	.....	7,200.00
1941	864,234.37	5,837.06	7,200.00	.....	7,200.00
1942	1,150,225.23	17,256.36	7,200.00	.....	7,200.00
1943	1,884,758.83	24,000.00	45,767.83	.....	45,767.83
1944	2,350,855.23	24,000.00	48,503.12	.....	48,503.12
1945	2,602,082.88	24,000.00	48,519.64	.....	48,519.64
1946	2,434,831.67	24,000.00	21,706.43	.....	21,706.43

(R. 11.)

The only testimony in the Tax Court on the value of Oswald's services was that of petitioner's witness, Abramson (R. 55-73), who testified that he was secretary of the Produce Reporting Company, a credit reporting agency of the wholesale fruit and vegetable business; that he had been connected with the Produce Reporting Company for 32 years; that his company published an annual Blue Book which gave financial and other ratings of about 150,000 fruit and produce businesses; that as secretary of his company it has been his duty and responsibility to collect the necessary data from the respective wholesale fruit and vegetable businesses and also to compile the information which went into the annual Blue Book. (R. 55, 56.)

Abramson further testified that in connection with his work he had called upon various concerns and talked with them about their operations; that he had met and talked with various fruit and vegetable men in their trade conventions; that they had called at his office and talked about their affairs with him; that from this experience and the information he received from the various concerns to be

used in the Blue Book he had learned what compensation is paid to executives and general managers of the wholesale fruit and vegetable business. (R. 62, 69-71.)

Abramson further testified that he was familiar with petitioner's business and that he had known Oswald for 20 years; and that in his opinion the value of Oswald's services for performing all of petitioner's executive and management services for 1943 was not less than $50,000.00 and for 1944 was not less than $60,000.00 to $65,000.00. (R. 65-69.)

He also testified that according to the information which he obtained in connection with his work, the amount paid to executives and management officers in the wholesale fruit and vegetable business averaged 2½% to 3% of sales for the fiscal years 1943 and 1944. Upon motion of counsel for respondent, this latter testimony only was stricken out by The Tax Court on the ground that it was hearsay. (R. 11, 69-71.)

The Tax Court rejected the testimony of petitioner's witness, Abramson, as to the value of Oswald's services, which was the sole testimony on that subject, and substituted its own judgment as to the value of such services, although there is nothing in the record to show that The Tax Court Judge, who decided the case had any independent personal knowledge, experience or judgment regarding the wholesale fruit and vegetable business in general, petitioner's business in particular, or the amount of compensation customarily paid for services of executive and management officers in the wholesale fruit and vegetable business, which would justify him in substituting his own judgment for the only testimony in the case. Petitioner's petition for a rehearing and review by the entire Tax Court was denied. (R. 83, 97, 98.)

The Court of Appeals below held that The Tax Court could reject the testimony of petitioner's witness, Abramson,

> "even though there is no other evidence on the subject" (R. 111);

and the Court of Appeals affirmed the Tax Court in its determination, although the Court of Appeals expressly held:

> "We find no evidentiary basis for an allowance of these particular amounts." (R. 113.)

QUESTION PRESENTED.

1. Whether the Court of Appeals below erred in holding that the Tax Court, in determining the amount of reasonable compensation under Sec. 23(a), Internal Revenue Code, may reject the opinion of an expert witness as to the value of services rendered by an officer to his corporation, and substitute the Tax Court's own judgment as to the value of such services under the following circumstances:

(a) Where the testimony of the expert witness is the only evidence before the Tax Court as to the value of such services; and

(b) Where there is no evidence that the Tax Court itself has any independent personal knowledge, experience or judgment regarding the subject matter; and

(c) Where the Court of Appeals itself expressly holds that there is no evidentiary basis in the record for the determination made by the Tax Court.

REASONS FOR GRANTING THE WRIT.

I.

The Court of Appeals below has rendered a decision in direct conflict with the decisions of the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits on the same subject. (Supreme Court Rule 38, No. 5(b).)

In the following cases, it was held that the Tax Court* may not reject the testimony of an expert witness, and arbi-

* These cases involve the Board of Tax Appeals, the name of which has been changed to The Tax Court of the United States.

trarily reach a conclusion of its own, where there is no other testimony on the subject, and where the Tax Court itself does not have any independent knowledge, experience or judgment of its own regarding the subject matter:

In *Pittsburgh Hotels Co.* v. *Com.* (Third Circuit), 43 Fed. (2d) 345, 347, involving the useful life of hotel property for depreciation purposes; *Boggs & Buhl, Inc.* v. *Com.* (Third Circuit), 34 Fed. (2d) 859, 860, 861, involving the valuation of good will; *Nachod & U. S. Signal Co.* v. *Com.* (Sixth Circuit), 74 Fed. (2d) 164, 167, involving the valuation of patents; *Capitol Barge Dry Cleaning Co.* v. *Com.* (Sixth Circuit), 131 Fed. (2d) 712, 715, involving the valuation of officers' services; *Planters' Operating Co.* v. *Com.* (Eighth Circuit), 55 Fed. (2d) 583, 585, involving the valuation of a hotel lease; *Belridge Oil Co.* v. *Com.* (Ninth Circuit), 85 Fed. (2d) 762, 768, involving the valuation of an option to purchase oil lands; and *Emerald Oil Co.* v. *Com.* (Tenth Circuit), 72 Fed. (2d) 681, 683, involving the valuation of oil lands.

II.

The Court of Appeals has decided an important question of federal law, which has not been, but should be, settled by this court. (Supreme Court Rule 38 5(b).)

Whether the Tax Court may disregard the testimony of an expert witness, where there is no other evidence on the subject, and reach an arbitrary conclusion of its own without any showing that the Tax Court has any independent knowledge, experience or judgment of its own regarding the subject matter,—is an important question of federal law which this Court has not decided, but should decide, for the purpose of uniformity of decisions of Courts of Appeals in cases involving petitions for review of decisions of the Tax Court.

PRAYER.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and to send to this Honorable Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 10,177, *R. H. Oswald Company, Inc., Petitioner* v. *Commissioner of Internal Revenue, Respondent;* and that the said judgment of the United States Circuit Court of Appeals for the Seventh Circuit may be reversed by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

R. H. OSWALD COMPANY, INC.,
By WALTER E. BARTON,
Investment Building,
Washington, D. C.,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION.

Opinion Below.

The opinion of the court below (R. 108) is reported in 185 Fed. (2d) 6.

Jurisdiction.

The jurisdiction of this Court is set forth in the petition on page 1 above.

Question Presented.

The question presented is set forth in the petition on page 6 above.

Statutes Involved.

The statutes involved are set forth in an Appendix attached to the brief.

Statement of the Case.

A statement of the case is made in the petition, beginning on page 2.

Specification of Error to be Urged.

The Court of Appeals erred in holding that the Tax Court could reject the testimony of petitioner's expert witness regarding the value of Oswald's services and reach a conclusion of its own as to the value of such services, where the testimony of petitioner's expert witness was the only testimony on the subject, and where there was no evidentiary basis for the Tax Court's conclusion, and no evidence that the Tax Court itself had any independent knowledge, experience or judgment of its own regarding the subject matter.

ARGUMENT.

I.

The Decision of the Court of Appeals Below is in Direct Conflict With the Decisions of the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits on the Same Subject.

Petitioner's expert witness testified that the value of Oswald's services for 1943 was not less than $50,000.00 and for 1944 not less than $60,000.00 to $65,000.00 (R. 66-69.) There was no other evidence whatever as to the value of such services. The Tax Court concluded that a reasonable allowance for Oswald's services for 1943 was $22,500.00 and for 1944 was $25,000.00. (R. 82.) There was no evidence whatsoever in the record from which The Tax Court could have found that Oswald's services were worth $22,500.00 for 1943 and $25,000.00 for 1944, *and The Court of Appeals so held.* (R. 113.)

Nor is there any evidence in the record which indicates that Judge Arnold, who decided the case in The Tax Court, had any independent knowledge, experience or judgment regarding the wholesale fruit and vegetable business or the compensation customarily paid to general managers and executives in such businesses; and The Tax Court refused to review Judge Arnold's decision. (R. 83.)

Notwithstanding there was no evidence as to the value of Oswald's services, except that of petitioner's expert witness; notwithstanding there was no evidence in the record that Judge Arnold or The Tax Court, had any independent knowledge, experience or judgement regarding the subject matters; and notwithstanding the Court of Appeals held that

> "We can find no evidentiary basis for an allowance of these particular amounts"

determined by The Tax Court (R. 113); nevertheless the Court of Appeals held that The Tax Court could reject

the testimony of petitioner's expert witness and substitute The Tax Court's own judgment which had no evidentiary basis. (R. 111.)

The decision of the Court of Appeals for the Seventh Circuit is contrary to the decisions of the Courts of Appeals for at least five other circuits.

In *Pittsburgh Hotels Co.* v. *Com.*, 43 Fed. (2d) 345, 347, the Third Circuit reversed the Board of Tax Appeals for refusing to accept the testimony of the petitioner's expert witnesses relative to the useful life of a hotel building for depreciation purposes, holding:

> "The Board as a general principle of law may reject expert testimony and reach a conclusion in accordance with its own knowledge, experience, and judgment, *but it must itself have knowledge of the subject-matter and experience with it.* There is no evidence whatever that the Board has any independent knowledge of the William Penn Hotel or the particular facts which in this case and locality produce depreciation. *It could not, therefore, arbitrarily disregard all the affirmative and positive testimony applicable to depreciation in this particular case.*" (Italics ours.)

The Third Circuit also held the same way in *Boggs & Buhl, Inc.* v. *Com.*, 34 Fed. (2d) 859, 860, 861, where the expert witnesses had testified as to the value of good will.

In *Nachod & U. S. Signal Co.* v. *Com.*, 74 Fed. (2d) 164, 167, the Board of Tax Appeals had disregarded the testimony of the taxpayer's expert witnesses relative to the valuation of patents for the purpose of exhaustion. The Sixth Circuit reversed the Board, holding:

> "It is true that such testimony, though often helpful, is not binding upon the Board to the extent that it is obliged to follow it if contrary to the judgment of its members. Nevertheless in every case the question must remain whether the value fixed by the Board is arbitrary and unsupported by substantial evidence, or represents a judicial determination reasonably founded upon evidence before it. Grand Rapids Store Equip-

> ment Corp. v. Commissioner, 59 F. (2d) 915 (C. C. A. 6). While the Board as a general principle of law may reject expert testimony and reach a conclusion in accordance with its own knowledge, experience, and judgment, *it must itself have knowledge of the subject-matter and experience with it.* Pittsburgh Hotels Co. v. Commissioner of Internal Revenue, 43 F. (2d) 345 (C. C. A. 3). It cannot arbitrarily disregard all affirmative and positive testimony applicable to value in a particular case." (Italics ours.)

The Sixth Circuit also held the same way in *Capitol-Barg Dry Cleaning Co.* v. *Com.*, 131 Fed. (2d) 712, 715, where the expert witnesses had testified as to the value of services.

In *Planters' Operating Co.* v. *Com.*, 55 Fed. (2d) 583, 585, the Board of Tax Appeals had disregarded the testimony of petitioner's expert witnesses as to value of a hotel lease. The Eighth Circuit held that it was well established:

> "That it is reversible error for the Board of Tax Appeals to disregard competent relevant testimony, when it is not contradicted."
>
> • • •
>
> "We think the testimony of these witnesses, who were qualified and experienced, should have been accorded weight, especially as the record does not disclose that the Board of Tax Appeals had any personal knowledge or experience on which to base a conclusion."

In *Belridge Oil Co.* v. *Com.*, 85 Fed. (2d) 762, 768, the Board of Tax Appeals had disregarded the testimony of petitioner's expert witnesses as to the value of an option to purchase oil lands. The Ninth Circuit reversed, holding:

> "While the Board may reject expert testimony and reach a different conclusion, to justify it in doing so, as pointed out by the authorities, it must itself have knowledge of the subject matter. There is no evidence whatever in this record to indicate that the Board itself has any independent knowledge of the particular facts in the case."

In *Emerald Oil Co.* v. *Com.*, 72 Fed. (2d) 681, 683, a case involving the testimony of expert witnesses as to the valuation of oil properties, the Board of Tax Appeals was affirmed, but in doing so the Tenth Circuit held:

> "The opinion of an expert as to value is not binding on the Board. A fact-finding body may disregard the opinion of an expert and use its own judgment as to value. * * * It may not reject opinion evidence and make an arbitrary finding of value based upon mere conjecture and unsupported by any substantial evidence. But the Board did not do that."

Mertons in his *Law of Federal Income Taxation*, Sec. 59.04, page 10 of Vol. 10A, says:

> "Expert testimony as to valuation of property cannot be disregarded by the Tax Court where there is no other evidence and that tribunal has no knowledge of its own in regard to the valuation of the property,"

citing a number of cases.

Petitioner submits that the decision of the Court of Appeals below is in direct conflict with the foregoing decisions of the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits.

II.

The Court of Appeals Below Has Decided an Important Question of Federal Law Which Has Not Been, But Should be Decided by This Court.

Whether The Tax Court may reject the testimony of an expert witness, which is the only evidence on the subject, and reach a conclusion of its own, which has no evidentiary basis in record, and where there is no indication in the record that The Tax Court itself has any independent knowledge, experience or judgment of its own regarding the subject matter,—is an important question of federal law which affects a large multitude of taxpayers throughout the United States.

The Court of Appeals below cited the opinion of this Court in *Dayton P. & L. Co.* v. *Public Utilities Com.*, 292 U. S. 290, 299, for the general rule that it is not error of law for a trial court or board to refuse to accept opinion testimony where there is other evidence. In that case there was other evidence from which the Commission could have determined the value of the properties in question, and there was no issue raised as to the Commission's right to substitute its own jugment without any evidentiary basis, for the testimony of expert witnesses, whose testimony was the only evidence in the case regarding the subject matter. This Court's decision in that case, therefore, is inapplicable to the question raised in the instant case.

Although the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits have overruled the Tax Court, the Tax Court persists in substituting its own arbitrary conclusion for the testimony of expert witnesses, without any evidentiary basis for its own conclusion, or any showing that it has any independent knowledge, experience or judgment of its own regarding the subject matter.

This Court has never decided the question, and petitioner submits that it should do so for the guidance of the Tax Court and the Courts of Appeals for the various circuits.

CONCLUSION.

It is respectfully submitted that the decision of the Court below is erroneous, and that the foregoing petition for a writ of certiorari should be granted.

WALTER E. BARTON,
Investment Building,
Washington, D. C.,
Counsel for Petitioner.

APPENDIX.

Statutes.

INTERNAL REVENUE CODE.

Sec. 23. Deductions from gross income.

In computing net income there shall be allowed as deductions:

Sec. 23(a) Expenses.

Sec. 23(a)(1) Trade or business expenses.

Sec. 23(a)(1)(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered. . . .

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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 555

R. H. OSWALD COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 74-82) is not officially reported. The opinion of the Court of Appeals (R. 108-113) is reported in 185 F. 2d 6.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1950. (R. 114.) A petition for rehearing was denied on December 15,

1950. (R. 129.) The petition for a writ of certiorari was filed on February 15, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the court below correctly decided that the amounts fixed by the Tax Court as reasonable salaries under Section 23 (a)(1)(A) of the Internal Revenue Code were not clearly erroneous.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 9-11.

STATEMENT

The facts as found by the Tax Court (R. 74-80), may be summarized as follows:

The taxpayer, a corporation, engaged in the wholesale grocery and fresh fruit and vegetable business, kept its books and made its returns on the accrual basis; it filed income, declared value excess profits, and excess profits tax returns for the taxable years, the fiscal years ended June 30, 1943, and June 30, 1944. (R. 74, 78, 79.) The taxpayer's capital stock was $30,000 and since November, 1937, R. H. Oswald, the president, has owned 290 of the 300 shares outstanding; his wife and brother each owned five of the remaining shares. (R. 74-75.) He has had extensive experience in the grocery, fruit and vegetable business and has been president and

general manager of the taxpayer since 1922. (R. 78.) Beginning with the year 1938 he performed all the executive and managerial duties of the taxpayer's business. (R. 78-79.) He worked long hours and never took a vacation. (R. 79.) In 1930 the board of directors by resolution authorized a salary of $7,200 to Mr. Oswald and in addition a percentage of the earnings when the latter exceeded 20% on the outstanding stock. (R. 75-76.) Under this resolution he received for the year 1930 an aggregate salary of $10,604.81; for the year 1931, $9,582.38; and for the year 1936, $8,595.31. Otherwise, his salary for the fiscal years 1930 to 1942, inclusive, did not exceed $7,200 per year. (R. 11.) In 1942 the taxpayer's board of directors voted him a salary of $800 per month ($9,600 per year), and when the net worth of the company should exceed $75,000, then all earnings above 80% on the par value of the outstanding stock,[1] as additional salary. (R. 14-15, 76.) A similar resolution was passed in 1943 and 1944. (R. 76.)

The taxpayer's net worth having exceeded $75,000 in the taxable years (R. 77), Mr. Oswald was paid a salary of $45,767.83 for 1943 and $48,503.12 for 1944 (R. 75). The taxpayer had paid no cash dividends since the fiscal year 1932. (R. 75.)

The Commissioner disallowed that part of the salaries paid Mr. Oswald for 1943 and 1944 in ex-

[1] $24,000 (80% of $30,000).

cess of $9,600 for each year. (R. 7.) Upon appeal to the Tax Court a reasonable allowance for compensation was fixed at $22,500 for 1943 and $25,000 for 1944. (R. 80-82.) Not satisfied with this substantial increase over the amount allowed by the Commissioner, the taxpayer appealed to the court below which affirmed the decision of the Tax Court (R. 108-113) and subsequently denied a petition for rehearing (R. 129).

ARGUMENT

The question as to what is a reasonable allowance for salary within the meaning of Section 23 (a) (1) (A) of the Internal Revenue Code and Sections 29.23 (a)-6 and 29.23 (a)-8 of Treasury Regulations 111, Appendix, *infra*, pp. 9-11, is essentially a question of fact. The amounts fixed by the Tax Court in this case are within the range of the evidence. The salary paid Mr. Oswald for six successive years preceding the taxable years was $7,200 (R. 11); the resolutions passed by the board of directors in 1943 and 1944 provided for a basic salary of $800 per month, or $9,600 per year, before adding a contingent share of the taxpayer's earnings as additional salary (R. 76); in accordance with the resolutions, Mr. Oswald was actually paid more than $45,000 for the fiscal year 1943 and more than $48,000 for the fiscal year 1944 (R. 80). The amounts fixed by the Tax Court, $22,500 for 1943 and $25,000 for 1944 (R. 80), are somewhere between the amount determined by the Commis-

sioner, $9,600 for each year (R. 7), and the amounts claimed by the taxpayer. There was evidence in the record to support the finding of lower salaries than $22,500 and $25,000 for the taxable years and also evidence to support higher salaries than those found by the Tax Court; thus, the Tax Court exercised its function as trier of the facts to weigh the evidence and reached the conclusion that $22,500 and $25,000 constituted reasonable salaries for the taxable years. The statement in the opinion of the court below that it found "no evidentiary basis for an allowance of these particular amounts" (R. 113), is not material, since the amounts found by the Tax Court were within the range of the evidence. The opinion of the court below (R. 108-113) shows that that tribunal carefully considered all of the evidence in the case and found sufficient factual support for the Tax Court's conclusion, so that it was unable to say that the decision of the Tax Court was clearly erroneous. Under similar circumstances this Court has repeatedly declined review. *Long Island Drug Co.* v. *Commissioner,* 111 F. 2d 593 (C.A.2d), certiorari denied, 311 U. S. 680; *Anthony P. Miller, Inc.* v. *Commissioner,* 164 F. 2d 268 (C.A.3d), certiorari denied, 333 U. S. 861; *Gem Jewelry Co.* v. *Commissioner,* 165 F. 2d 991 (C.A.5th), certiorari denied, 334 U. S. 846; *Ecco High Frequency Corp.* v. *Commissioner,* 167 F. 2d 583 (C.A. 2d), certiorari denied, 335 U. S. 825; *L. E. Pinkham*

Med. Co. v. *Commissioner,* 128 F. 2d 986 (C.A. 1st), certiorari denied, 317 U. S. 675; *Em. H. Mettler & Sons* v. *Commissioner,* 181 F. 2d 848 (C.A. 9th), certiorari denied, 340 U. S. 877.

The taxpayer contends that the decision of the court below is in direct conflict with the decision of other Courts of Appeals in which it was held that the Tax Court may not reject the testimony of an expert witness where there is no other testimony on the subject and where the Tax Court itself does not have any independent knowledge, experience or judgment of its own regarding the subject-matter. (Pet. 6-7; Br. 10-13.) Only one of the cases cited by the taxpayer (Pet. 7; Br. 11-13) involves the reasonableness of salaries, *Capitol-Barg Dry Clean. Co.* v. *Commissioner,* 131 F. 2d 712, 715 (C.A.6), and in that case the court indicated that it depended upon its peculiar facts. Consequently, there is no direct conflict of decisions. This Court has held in a case involving the valuation of property that opinion evidence is not conclusive, and that a failure to follow such opinion evidence alone is not an error of law. *Dayton P. & L. Co.* v. *Comm'n,* 292 U. S. 290, 299.

Moreover, this case does not conflict with the rule announced in the cases relied on by the taxpayer, for the fundamental premise of that rule, that there be no evidence other than that of the expert, does not exist here. The record shows Mr. Oswald's salary for a period of more than 20 years;

his highest salary prior to the taxable years was $10,604.81 in 1930; and he received $7,200 a year for six successive years immediately preceding the taxable years. (R. 11.) There was no evidence to show such an increase in hours of work and duties between 1942 and 1943 as to justify an increase in salary from $7,200 to $45,767.83. Furthermore, the record shows that since November, 1937, Mr. Oswald owned 290 of 300 shares of the taxpayer's stock, or more than 96%, so that he was entitled to substantially all of the taxpayer's earnings; and no cash dividends have been paid since 1932. (R. 75.) As Section 29.23(a)-6 of Treasury Regulations 111, Appendix, *infra*, pp. 9-11, points out, an ostensible salary paid by a corporation to its principal stockholder may be a distribution of a dividend on stock. The circumstances here warrant that inference. It also may be noted that the taxpayer's failure to introduce evidence of the salary paid for similar services by a single corporation in a similar business under like circumstances justifies the inference that other concerns in the same sort of business did not pay salaries as high as those paid by the taxpayer.

CONCLUSION

The decision of the court below is correct and depends upon the circumstances of this particular case. There is no conflict of decisions, and further review is not warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
HELEN GOODNER,
MORTON K. ROTHSCHILD,
Special Assistants to the Attorney General.

MARCH, 1951.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23 (a)-6. *Compensation for Personal Services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services.

This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (*a*) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. * * *.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduc-

tion even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

SEC. 29.23 (a)-8. *Bonuses to Employees.*— Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income.

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